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Combatting international tax avoidance and evasion

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Introduction

The main income of most governments consists of taxes levied on their inhabitants and companies located within their borders. For the taxpayers, the amount of tax to be paid decreases their yearly income or profit, sometimes by a considerable amount. Most of them do not specifically like paying taxes but do so because of a sense of duty or out of fear for prosecution. A small part of all institutions that officially ought to pay taxes, decide to avoid doing so through various ways, this is called tax evasion. On the other hand, some groups do not have to pay as much taxes as others because the government wants to support them. Currently, governments miss out revenue as a result of this tax evasion or aggressive tax avoidance, which causes them to raise taxes for other inhabitants. This is considered unjust and therefore many organizations have tried to stop this tax noncompliance. Yet further implementation of already existing frameworks and cooperation is needed to strengthen the international fight against tax avoidance and tax evasion.

Definition of Key Terms

Tax

Money demanded by a government from its inhabitants or from companies or organizations that are established in that country. The money is used to pay for common goods, such as infrastructure, education or jurisdiction.

Tax avoidance

Preventing oneself, whether it be a company or an individual, from paying at least a part of the required taxes by legal means. Tax can be avoided in more ways. For companies, this is usually establishing the company or at least its headquarters in a country where taxes for companies are relatively low. For individuals, tax avoidance can consist of investing their income in, for example, pension plans, real estate or investments funds. In doing so, they avoid paying taxes directly. When the money is extracted after a period of time, taxes are lower than they would originally have been. It is also possible to make use of flaws in a country's legislation in order to pay less tax than originally intended by a government. Most forms of tax avoidance are perfectly legal, as it does not violate laws and at times is even encouraged by governments.

Aggressive tax avoidance

(Also referred to as: Aggressive Tax Planning (ATP)) While some forms of tax avoidance are officially legal, aggressive tax avoidance has been criminalized in several countries. The line between tax avoidance and aggressive tax avoidance is thin, and no official definition of aggressive tax avoidance is available. The core of the difference is that in order for tax avoidance to be aggressive it should go against the purpose of the law, while not literally violating it.

Base erosion and profile shifting (BEPS)

A term used by the Organization for Economic Co-operation and Development (OECD) to refer to the strategies used by multinational companies to avoid taxes. As a result of the quickly developing international market, tax laws are not always up to date. Companies can use gaps or mismatches in laws to pay less or no tax. Especially for developing countries, BEPS is an important issue. They rely heavily on taxes received from multinational companies and through BEPS they could lose this income.

Tax evasion

The illegal evasion of paying taxes. It is a crime that can be committed by all those who are by law obliged to pay taxes. The goal is to lighten one's financial burden through paying less tax than other similar companies or households. Tax liability is decreased through, for example, reporting to the government a lower gain or income than the factual amount. In black market circuits, tax in its entirety is evaded as well.

Tax non-compliance

The combination of tax avoidance and tax evasion. Tax noncompliance prevents governments from gathering money that would otherwise have been theirs.

Double taxation

When a company invests in something and gains profit, it pays tax over this profit. The investors of the company also gain a certain amount of money for risking losing their investment. Often, this income is also taxed. This is called double taxation and is a motive for evading taxes, as the investment has to be very profitable for investors to gain the expected amount of money.

General Overview

The issue of tax avoidance and tax evasion is an intricate one. First of all, tax avoidance is not illegal in most countries, thus it can be done legally. When collecting taxes, governments might want to support for example low-income groups, students, or companies with certain qualifications. In order to do this, they make it possible for these groups to pay less tax, thus lightening their tax burden. This form of tax avoidance is legal as it is in line with the law.

Aggressive tax avoidance

However, at times companies or wealthier individuals make deliberate plans to avoid taxes. They try and find mazes in the law through which they can lower their amount of tax, or even avoid paying taxes at all. As of now, this aggressive tax avoidance is still legal in most countries, even though it violates the purpose of the law. That is why tax avoidance in this issue should mostly be considered as aggressive tax avoidance or aggressive tax planning. A special form of aggressive tax avoidance is BEPS. Because large amounts of money can be saved in a legal way by large companies through making use of gaps in the law, they are prepared to spend some money on finding these gaps. Larger companies have the money to hire specialists who can work out an aggressive tax plan, while smaller companies do not have the capacity to make such investments. This is just one of the many ways in which the larger, often multinational companies can gain power in comparison to the smaller, local ones. This has serious results for the local inhabitants, as profits made by the larger companies are seldom invested in the local economy.

Consequences

Both aggressive tax avoidance and tax evasion deprive the government of income. As tax avoiders and evaders still make use of facilities in the country, this results in the government having to pay the same amount of money for common goods whilst having less income. Other taxpayers are billed a larger amount of money than would have been the case if everyone had paid taxes. So tax avoiders and evaders do not only pay less tax themselves, they also cause other taxpayers to have to pay more tax. The financial situation of tax non-compliers relatively improves in two ways, whereas the financial situation of tax compliers worsens. This is unjust and therefore should be diminished insofar that is possible.

Many measures could be taken against either aggressive tax avoidance or tax evasion, as there are many ways of doing it. The simplest form of tax evasion, simply deceiving the government of the amount of income earned, can never be prevented altogether. However, by verifying the records of companies and their employees at random, offenders are detected and most often have to pay a fine. As this kind of tax evasion is risky, larger companies usually go by offshore tax evasion. This means that a company's home jurisdiction is a tax haven, because of which the company does not have to pay much tax. The most important parts of this company are still situated in another country. In order to detect offshore tax evasion, transparency on the international level must be reached.

Major Parties Involved and Their Views

The Organization for Economic Co-operation and Development (OECD)

The goal of the OECD is designing, improving and promoting financial policies through which the economic or social situation of people around the world can be improved. In order to achieve this improvement of situations, the OECD collects data and analyses and discusses gained information or existing policies. Currently the OECD has 34 member countries, yet it has data on all UN member states and their recommendations can be used by all governments. The OECD has published several documents on the topic of tax avoidance and tax evasion.

European Commission

Apart from fighting tax avoidance and tax evasion within their own member states, the European Commission tries to promote coordination on tax matters amongst other nations. Next to its collaboration with the OECD, it has published an action plan to prevent tax avoidance and evasion. Though it is originally meant for EU members only, its ideas could be used on a larger scale.

Committee of Experts on International Cooperation in Tax Matters

This committee is a subsidiary body of the ECOSOC. Its main goal is to promote cooperation between UN member states. To this end, the Committee has published two major documents, which are updated from time to time. These documents offer guidelines for implementing tax treaties and conventions between Developed and Developing countries.

G20

The Group of Twenty (20), whose members' economies comprise about 80 percent of the world trade, also has stressed the importance of tax transparency quite often. According to the G20, the globalizing international market has increased opportunity for tax evasion. In order to solve this problem, they hope to adapt the international rules regarding tax so that especially tax evasion can be prevented.

UN involvement, Relevant Resolutions, Treaties and Events

The goal of the EOIR, which was implemented by the OECD, is to enable governments to request financial information of other governments. If tax noncompliance is suspected, governments can investigate the case with information from other governments. This standard makes obtaining such information easier.

The Standard for Automatic Exchange of Financial Account Information (AEOI) succeeded the EOIR and was also published by the OECD. It contains rules on exchanging information and enables governments to obtain information from their banks, tax agencies or companies and to exchange this information automatically with other governments. Through this cooperation, greater transparency is acquired on international levels and offshore tax evasion can be detected more easily.

The United Nations Model Double Taxation Convention between Developed and Developing Countries is one of the documents published by the Committee of Experts. As double taxation fuels tax evasion, it is important for countries to assure themselves of not taxing investors twice. This document does not have anything to do with tax evasion and avoidance directly, yet its implementation is of significance for the trust in governments.

The Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries pressed that transparency is, if not the most, a very important part of the issue of tax avoidance and evasion. Transparency between MEDCs has been achieved insofar that is possible. Data exchange between LEDCs is not as important, as the larger multinational companies usually originate from MEDCs and not from other LEDCs. That leaves data-sharing between MEDCs, where the companies sell their products, and LEDCs, where the companies produce and at times find a developing market, or have established their headquarters because of low or easily avoidable taxes. If these countries could have access to each other's data, tax evasion and avoidance can be detected and if found illegal, committers can be prosecuted.

- The Exchange of Information on Request (EOIR)
- The Standard for Automatic Exchange of Financial Account Information (AEOI)
- The United Nations Model Double Taxation Convention between Developed and Developing Countries
- The Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

Evaluation of Previous Attempts to Resolve the Issue

As you have read, many organizations have published a large amount of documents on the prevention of tax evasion and tax avoidance and resolutions have been passed on the issue as well. Transparency between MEDCs is now well organized, for example between the member of the G20 or within the European Union. That leaves a couple of problems: the transparency between LEDCs and MEDCs has not been maximized yet. Also, aggressive tax avoidance is not yet illegal in all countries, which makes prosecution impossible. Furthermore, tax evasion through deception of the government or trade on the black market remains hard to solve. This can be due to lack of capacity, or because data exchange between banks and the governments' tax agencies is not up to date.

Possible Solutions

Not only would transparency between countries make tax avoidance and tax evasion easier to detect and to deal with, it also has proven to have many other positive effects. Through enhancing data transparency between countries, crimes such as money laundering or human trafficking become harder to commit undetected. Whereas many More Economically Developed Countries (MEDCs) exchange a lot of data, Lesser Economically

Developed Countries (LEDCs) may lag behind. This is piteous, as especially these nations could develop greatly with the revenue they now lose. These countries could use the Manual for Negotiation by the Committee of Experts to establish data-sharing relations with other countries. However, it should always be up to the governments' own discretion to decide whether they want to cooperate with other countries or not.

Also, some countries have banking secrecy laws, which means that banks do not have to permit access by a government or other banks to their data. Although this can be seen as another issue entirely, the committee can make recommendations on or speak against the current system in nations with bank-secrecy. It might be worthwhile to seek for a compromise. One way to prevent the violation of privacy, would be for software to go over all banking data to check whether accounts might be used for evading taxes. If this is the case, the evader can be prosecuted. If this is not the case, no human being has had access to the information of the account's owner.

Another aspect of this problem is the existence of tax havens. Should countries where taxes are exceptionally low raise their taxes in order to make these countries less attractive, or should they not approve of multinational companies establishing their headquarters in the country? Another possible solution that could be considered is asking countries where the taxes are high to lower them. This will encourage countries to pay taxes in the country where they have their headquarters. However, this could mean a decrease in income for these states, as companies that already did pay taxes in that nation would pay less as well. All solutions mentioned in this paragraph might seem rather controversial, and it remains to be seen whether they would agree at all and whether these measures would be worth taking them.

Then there is the issue of aggressive tax avoidance. The idea behind tax avoidance is to spare vulnerable or useful groups in society. The problem is that parties for whom this possibility to lighten the tax burden is not meant, take advantage of these rules. To make these parties liable again, either the rules regarding tax avoidance have to be changed, or it should be made possible to prosecute aggressive tax avoiders. Changing the rules could accidentally destroy the idea of tax avoidance, as it might be possible that the groups for whom tax avoidance is meant now have to pay more taxes. In order to change these laws, the effects of the adaptations must first be carefully examined. Prosecuting tax avoidance might lead to unjust convictions, as it would be up to the lawyers' interpretation to decide whether an action is in line with the law or not. Though this problem might not seem international at first, keep in mind that tax-paying instances are likely to aggressively avoid taxes through moving to countries where ‘legal’ tax avoidance is easy. Also, all nations suffer from these problems and international cooperation towards this issue might be a step towards tackling the problem.

Lastly, the easier forms of tax evasion ought to be tackled. If the capacity of national authorities increases, the records of more persons can be checked at random. Black market activity can be detected and stopped by for example implementing fines. Another way of preventing deception of the government is through data exchange between banks, companies and the government. If an individual were to indicate that he has earned less than the company records say, this would spring out from other tax files immediately. Currently, these easy tax evaders are detected if they are randomly checked. It would be more efficient if data could be linked automatically through a program. This would however lead to another problem: all information will be stored in one place, and this could be seen as a risk for privacy safeguarding.

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Appendix or Appendices

Appendix I

Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries and Model Double Taxation Convention between Developed and Developing Countries:

http://www.un.org/esa/ffd/wp-content/uploads/2014/09/UNPAN008579.pdf